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DDI-5691-82

21 June 1982

MEMORANDUM: Director of Central Intelligence
Deputy Director of Central Intelligence

VIA: Deputy Director for Intelligence

FROM: [redacted] 25X1
Acting Director of Soviet Analysis

SUBJECT: Possible Soviet Responses to Alternative US Policies on Grain Sales

1. Action. None - for your information only. [redacted] 25X1

2. Background. In view of recent US policy discussions about sales of grain to the USSR, SOVA and OGI analysts have taken a new look at Soviet import needs. This memorandum examines (a) the possible effects on the Soviet hard currency position and on Soviet policy of alternative US policies regarding the volume and terms of grain sales to the USSR and (b) the limits to the leverage that such options might provide the United States. [redacted] 25X1

[redacted] 25X1

Attachment:
As stated

[redacted] 25X1

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SOVA/SE/T:JMC:jvdv [redacted] (9 July 82)

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Possible Soviet Responses to Alternative US Policies on Grain Sales

Introduction

1. On 23 May, Under Secretary of Agriculture Lodwick, speaking at the conclusion of two days of talks in Paris with Soviet trade officials, indicated that the US was willing to sell Moscow more US grain than the 23 million tons already permitted during the final year of the Long Term Agreement. He did not state whether any restrictions would be placed on the terms of grain sales. Control over the terms of grain sales to the USSR, however, remains a possible inducement to cooperative Soviet behavior in the foreign policy arena. 25X1

Soviet Grain Requirements

2. In marketing year 1982 (July 1981-June 1982) the Soviet Union will import about 45 million tons of grain. Because Moscow needs to replenish stocks drawn down over the past three years, we expect Soviet purchases to continue at a high level--perhaps 40 million tons in marketing year 1983. 25X1

3. Moscow will not be able to solve its grain problem on its own in the next several years. The new Soviet food program, announced by Brezhnev at a Central Committee Plenum on 24 May, calls for average annual grain production to reach 238-243 million tons in 1981-85 and 250-255 million tons in 1986-90. With a grain crop of 158 million tons in 1981, production in 1982-85 would have to average about 260 million tons to reach plan--23 million tons above the record crop of 237 million tons in 1978.

4. A simple projection of grain output during the 11th FYP --based on the 1960-80 trend--would indicate average production of 226 million tons in 1981-85. But this projection is probably too high unless the Soviets experience a period of above average weather. Because the Soviets experienced unusually favorable climatic conditions from the mid-1960s to the mid-1970s, a projection based on 1960-80 trend is biased upward. With average weather--and assuming no major technological breakthroughs--annual production of 212 million tons in 1981-85 would be a more

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reasonable prospect. An average crop of this size would fall more than 30 million tons below the total needed each year to sustain Soviet meat and livestock programs and build up inventories. Fluctuations in the year-to-year grain crop would, of co[redacted] result in higher or lower demand in any particular year. [redacted] 25X1

Sources of Grain

5. The Soviet Union can satisfy most of its import requirements from non-US sources. Global grain production has been growing at a faster rate than consumption during the last two crop years. This buyers' market is likely to continue. Increased consumption awaits an economic recovery in the West, and barring major weather setbacks in the next few years, the availability of grain from non-US sources likely will increase. Nonetheless, the United States will continue to be the dominant force in the world grain trade. It still accounts for 60 percent of the exports of coarse grain and roughly one-half of the wheat that is traded. [redacted] 25X1

6. The USSR currently has arranged for a minimum of 10 million tons of grain purchases per year under Long Term Agreements with Canada, Argentina, Brazil, Thailand, and Eastern Europe. Moscow can probably find an additional 20 million tons of grain without turning to the United States. After total purchases exceed roughly 30 million tons per year--or if the Soviets need more corn than Argentina can deliver--they would have to turn to the United States. [redacted] 25X1

Possible US Options

7. Although Moscow might not be initially disposed to buy any more than absolutely necessary from the United States, we can influence the terms under which all grain is purchased by the USSR. Because of its unfavorable hard currency position, the Soviet Union has been searching for credit of up to two years duration to finance grain purchases. Bankers are reluctant to extend even one-year financing in the current unsettled climate regarding lending to Eastern Europe and the USSR. In practice, only a few small loans have been given for more than six months duration.

8. The United States, by offering to extend three-year credits under liberal terms, could offer the USSR substantial help in easing the financial burden of a large grain import bill. Alternatively, a restrictive US policy that discouraged foreign governments from offering guarantees or concessionary terms would be especially costly to the Soviets. A third, middle-ground option might give implicit support to a return to

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business as usual, with the Soviets receiving commercial credits at market rates but with longer maturities than are now being offered.

9. Under the first, most liberal option the United States could offer credits to the Soviet Union for grain purchases at highly favorable terms--three-year maturities and an interest rate of 11 percent. This rate represents the proposed OECD consensus rate for the USSR and is currently about 3-6 points below market. Sales under these conditions would allow the USSR to substantially stretch out hard currency outlays. In order to implement such an arrangement, the US government would probably have to provide bankers with some element of guarantee and interest rate subsidies. With such a US policy in place the other grain supplying nations would probably quickly offer similar arrangements to the USSR to maintain their respective share of the Soviet market.

10. At the other extreme, the United States could even more actively than at present discourage foreign governments from offering any form of credits through offical channels. If the US could convince other governments not to underwrite Soviet grain purchases, Moscow would have to rely solely on commercial financial institutions for grain credits. In these circumstances bankers, who take their cue from government policy, would be reluctant to extend such credits and would demand high interest rates--at least some percentage points over the London Inter-Bank Offered Rate (LIBOR) which is currently around 15 percent. Bankers would also not be likely to offer maturities much in excess of six-months. As a result, the costs to the Soviets of their grain purchases would be increased, and the benefits acrued from savings in hard currency would be short-lived.

11. The third option is basically one in which the market determines the terms, with US policy neither actively supporting nor discouraging grain financing activities. With such a policy--which also might be viewed by the financial community as an effort by the US to ease East-West tensions--bankers might be more willing to extend credits to the USSR. The Soviets would probably be able to obtain interest rates close to LIBOR and one-year maturities, longer than they are now receiving. Official guarantees could be forthcoming from some countries in support of their grain trade, but there would be little pressure to subsidize such credits.

12. The effects of the possible options vary widely. The savings to the USSR if the credit terms were liberalized could be substantial. As shown in Table 1, Moscow might save almost $4 billion in hard currency during 1982-84 if it were able to obtain

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USSR: Costs of Financing Grain Purchases Under Alternative Credit Terms

(Million US $)

	1982	1983	1984	Total 1982-1984
Grain Purchases				
Total value	6,300	6,300	6,300	18,900
Portion financed[1]	5,355	5,355	5,355	16,065
Option One[2] (Liberal credit terms)				
Total debt service	863	3,040	5,021	8,924
Repayments of principle	446	2,230	4,014	6,690
Interest	417	810	1,007	2,234
Total outlays for grain[3]	1,808	3,985	5,966	11,759
Option Two[4] (Restrictive credit terms)				
Total debt service	3,134	5,811	5,811	14,756
Repayment	2,678	5,355	5,355	13,388
Interest	456	456	456	1,368
Total outlays for grain[2]	4,079	6,756,	6,756	17,591
Option Three[5] (Market determined credit terms)				
Total debt service	603	6,159	6,159	12,921
Repayment	0	5,355	5,355	10,710
Interest	603	804	804	2,211
Total outlays for grain[2]	1,548	7,104	7,104	15,756

1 Assumes that financing covers 85 percent of purchases (assumed to continue at the 1981 level of 41 million metric tons at $154 per ton).

2 Assumes three-year credit terms and an interest rate of 11 percent, which is the proposed OECD consensus rate for the USSR. Credits are drawn on 1 January and 1 June, interest is paid at the end of each 6-month period on the outstanding balance at the beginning of the period, and repayments are made in six equal installments, with the first payment falling due at six months after a loan is made.

3 Grain purchases paid for in cash (15 pecent of the total) plus debt service.

4 Assumes 6-month credit terms with an interest rate of 17 percent. Credits are drawn on 1 January and 1 June and interest is paid at the end of each 6-month period on the outstanding balance at the beginning of the period. Loans are repaid 6 months after they are drawn.

5 Assumes one-year credit terms with an interest rate of 15 percent. Credits are drawn on 1 January and 1 June and interest is paid at the end of each 6-month period on the outstanding balance at the beginning of the period. Loans are repaid one year after they are drawn.

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liberal three-year financing terms rather than the terms that would be available if market forces were allowed to function normally (i.e., option 3.) On the other hand, the successful implementation of the second option (i.e., harsher credit terms) could add an additional $1.8 billion to the cost of Soviet outlays for grain purchases under market determined conditions.

Possible Soviet Responses

13. A liberal credit package, or even a US policy of letting market forces hold sway would probably evoke favorable changes in the atmospherics of US-Soviet relations but would in itself provide only slight leverage over Soviet behavior. It is possible, nevertheless, that if combined with other carrots and sticks, such a policy tool could induce the Soviets to moderate their stance on some bilateral issues. For domestic political reasons, however, the Soviets would strongly resist any public linkage between their behavior and US actions, as they did after the Jackson-Vanik and Stevenson amendments were passed. 25X1

14. Moscow might respond positively to a grain deal in several ways. It might be willing in return to improve the climate for arms control discussions (but not to make major concessions). A more lenient attitude toward some Soviet dissidents could emerge, including ultimate disposition of emigration for the Pentecostals. Increased emigration of Soviet Jews and other minorities is another possibility. On balance, however, offering more grain on easy terms is unlikely to lead to significant amelioration of major outstanding political differences. 25X1

15. If the US were to choose the second option, Moscow's likely response would be to increase its efforts to line up guaranteed grain supplies under long-term agreements from non-US exporters. Armed with the prospect of increased purchases as an incentive, the USSR would attempt to drive a wedge between the US and other Western grain exporters in order to undercut US initiatives. The Soviets also probably would review harsher credit terms as another example of US policy aimed at "economic warfare." This, in turn, might cause them to retaliate by taking a more aggressive posture in Namibia, Nicaragua, or other Third World areas. At a minimum, they would more energetically seek to alienate the US from its allies. 25X1

Other Considerations

16. Although potentially attractive to the Soviets, liberalized financing is not essential to continuation of large grain purchases. In the short run, the Soviets could sell gold to finance some of the purchases. For example, in 1982 the

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additional hard currency cost of the second option as opposed to the first is roughly $2.3 billion--equivalent to about 200 tons of gold at current prices, or an amount roughly equal to sales last year. Moreover, the prospects for additional arms sales in the Middle East also may be brighter after the recent events in Lebanon. Finally, the savings to the Soviets are transitory unless the value of new credits increases over time. (Compare the differences in payments in the table for 1984 under all three options.) 25X1

17. Moreover, a policy of restrictive credits would be very difficult to implement. Given the buyers' market and their own economic problems, governments of the major non-US grain suppliers such as Australia, Canada and Argentina would be reluctant to go along with any US initiative. 25X1

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